



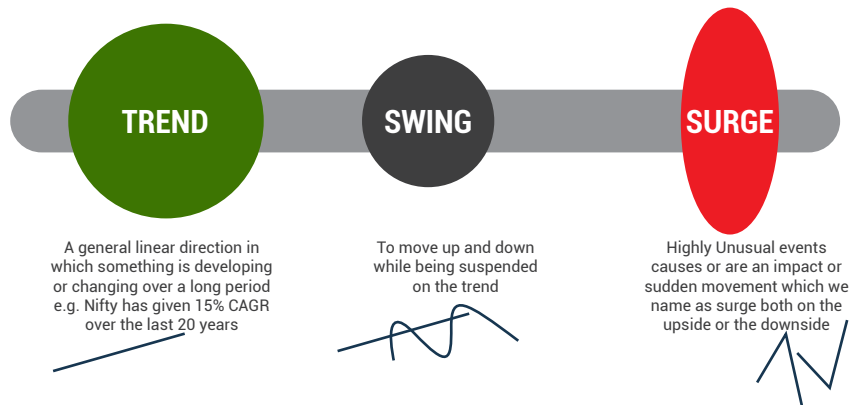
MARKET PERSPECTIVE

Markets Settling to a New Normal

July 2022

TREND - SWING AND SURGE

Trend is a general linear direction in which something is developing or changing over a long period, e.g. Nifty has given 15% CAGR over the last 20 years. Swing is to move up and down while being ultimately attached on the trend. Stock markets normally follow a Trend and Swings pattern. Surges are rare events sometimes also called Black Swan events. But invariably the impact of the surge wanes and the market gets back on the normal trend trajectory.



Many investors get unnerved when after investing their money in the stock market they see poor returns or losses in the portfolio in smaller time frame. Here it is important to understand the concept of Trend, Swing and Surge.

NIFTY-TREND-SWING-SURGE



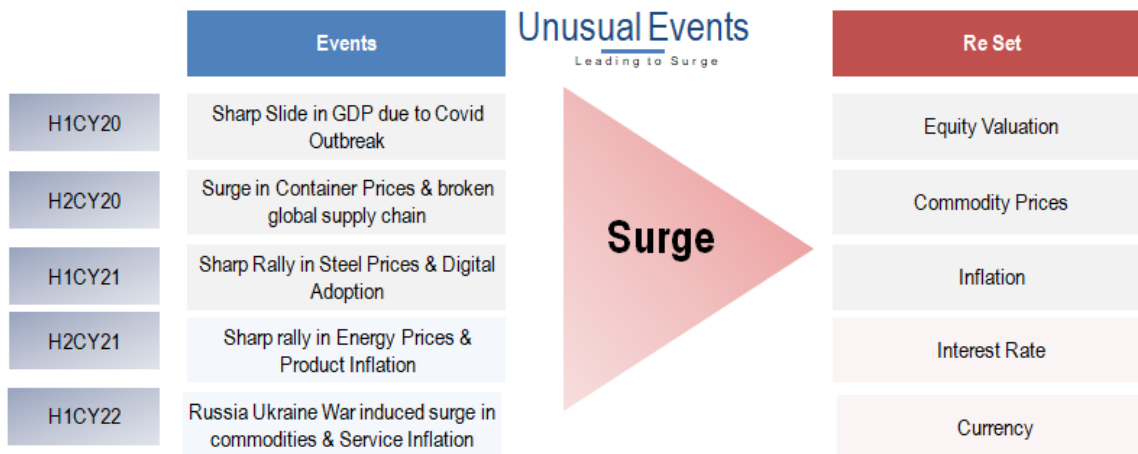
Return for Short-term Investors=Return from the cyclical Swings

(+/-) Return from Surge during period

Return for long term Investors=Return from the Underlying Trend

- » Swings are the more important source of investment return in the short term. While one is buying whether market is near swing high or swing low and similarly when one is computing investment return whether market is near swing high or swing low dramatically changes the perceived returns from the market.
- » Surges are rare events sometimes also called Black Swan events. These happen rarely like the one we witnessed during March 2020 (when covid related uncertainties arose) but have large impact on the asset class performance in near term. But invariably the impact of the surge wanes and the market gets back on the normal trend trajectory.
- » When one invests for a long time, the investment goes through multiple rising and falling swings almost cancelling each other out and what one ultimately receives is the Trend return.

BLACK SWAN GOT HIGHLY POPULATED IN POST COVID RE SET



- » Over the last two years multiple high impact macro events have played out. H1CY20- sharp slide in GDP due to Covid outbreak, H2CY20- surge in container prices and broken global supply chain, H1CY21- sharp rally in steel price, high digital adoption, H2CY21- sharp rally in energy prices & product inflation, H1CY22- Russia Ukraine war and induced surge in commodity & services inflation. And all these macro events were highly impactful keeping the volatility high in various financial markets.
- » Large part of the re-set that was needed in equity valuation, commodity prices, bond rates and currencies in response to these volatility inducing events have already taken place. In fact the high volatility period should be over in next few quarters and markets particularly equity will exhibit low volatile high trending regime in the medium term going ahead.

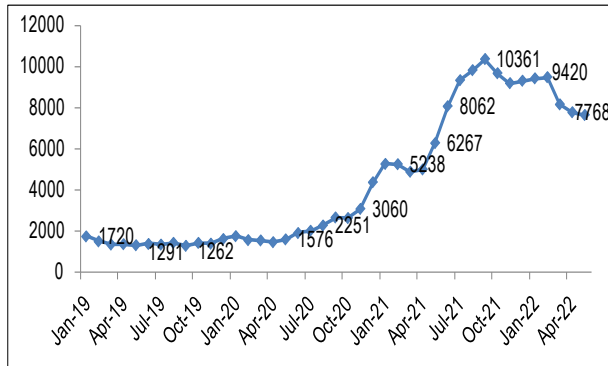
PRE SURGE - SURGE - POST SURGE SCENARIO

| | Base | Peak | Current |
|-------------------------------|-------|-------|---------|
| Wheat USD/Bu | 510 | 1277 | 933 |
| Commodity Freight USD/1000 | 1540 | 10361 | 7635 |
| Steel Prices CNY/T | 3600 | 6000 | 4400 |
| Palm Oil MYR/T | 2500 | 7000 | 4700 |
| Aluminium USD/T | 1977 | 3966 | 2522 |
| Nickel USD/T | 17000 | 48240 | 25896 |
| Cotton USD/lbs | 78 | 158 | 114 |

- » Markets post surge are now finding equilibrium in the Equity valuation ratios, Commodity Prices, Inflation, Interest rates and Currency. Aluminium prices from base of 1977 had surged to 3966 USD/ tone and are now already back to 2522 levels. In Agri commodities, cotton rose from 78USD/lbs to 158 USD/lbs and now corrected to 114 levels.
- » Except for Crude and some Agri commodities most commodity prices have corrected back by nearly 50%-80% from their highest prices.

MACRO SCENARIO

Global container freight rate index from January 2019 to April 2022 (in U.S. dollars)



Source: <https://www.statista.com/statistics/1250636/global-container-freight-index/>

After swinging widely, Steel Prices are softening

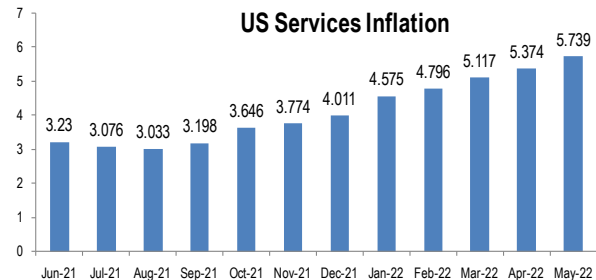
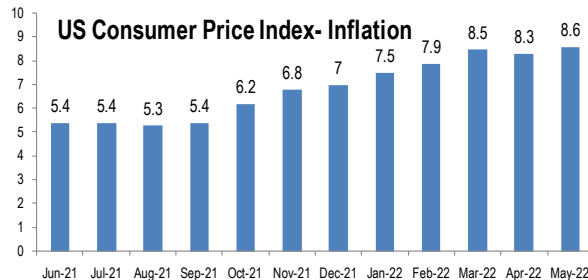


Source: <https://tradingeconomics.com/commodity/steel>

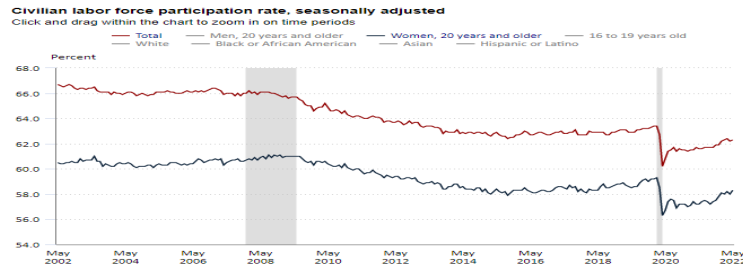
- » Container freight Index which rose from 1200-1500 USD per tonne to 10300 USD per tone is now settling at around 7600USD/tonne. Container Freight Index is an important indicator to track disruption associated with global supply chain.
- » Steel prices which rose to 6000CNY/T from the base of 3600 is now corrected back to 4000 levels.

US INFLATION IS MORE OF A LOCAL CONCERN NOW

As regards US Inflation, Since Mar 22, hike in inflation more of a factor of US services Inflation. To our mind, the ripple off effect of US inflation (more due to supply constraints) to other countries should slow down as US service Inflation is more of a local concern for US. This should be handled well as Job Participation in the country improves to 66 levels from currently around 62.



US Job Participation



Source: <https://tradingeconomics.com>

LESSER ROOM FOR EXPANSION IN INDIA 10 YEAR BOND YIELD

10 year Bond Yield-India



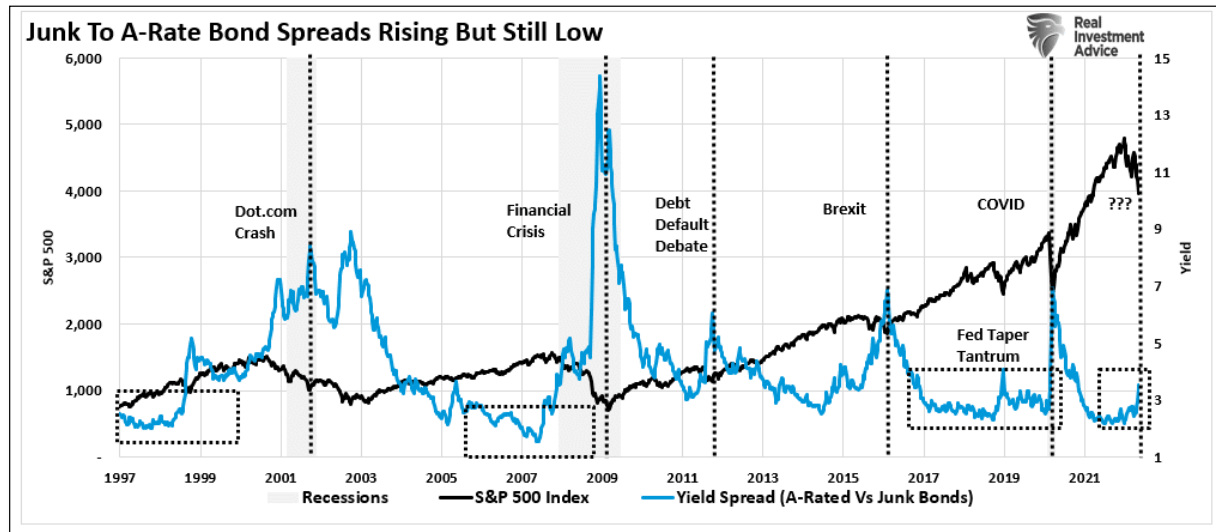
USA Interest rate differential with India



Source: <https://in.investing.com/rates-bonds/india-10-year-bond-yield-historical-data>

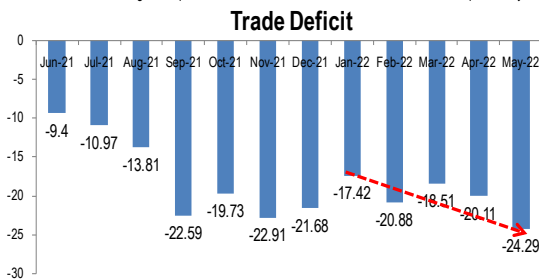
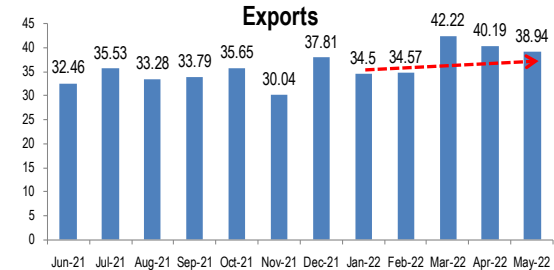
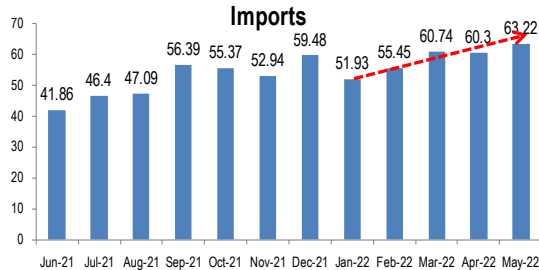
- » India's 10 year Bond yield is already high at 7.47% and we do not see it rising too higher even if RBI raises Interest rates. Keep in mind that during 2018 Loan Crisis also, the bond Yield went up to maximum of 8.3% and now it is already at 7.47%. The economic scenario in the debt market is far better than in 2018-19.
- » World over interest rate has kept falling for the last 15 years though there is a sharp increase in interest rates in near term. However, India USA Interest rate differential is on a declining trend which assures India's competitiveness over other countries.

CREDIT STRESS WILL BE EARLY INDICATOR OF FED PAUSE



- » US Junk to A rate Bond spreads are rising but still low. This would be the key early indicator to gauge both recessionary risk in US and change in stance by the US FED

CURRENCY FALLING TO 80 WILL HELP EXPORTS-- CURRENCY PERIOD



Source: <https://in.investing.com>, www.tradingeconomics.com



- » India Currency is now at 78. We assume currency reset is yet to happen. Out Balance of payment has not reset yet. The imports have continued to grow (courtesy: Energy prices) but the Exports are stagnant. Currency depreciation will become favorable for India as it will help exports and reduce imports of other goods and improve our Deficits.

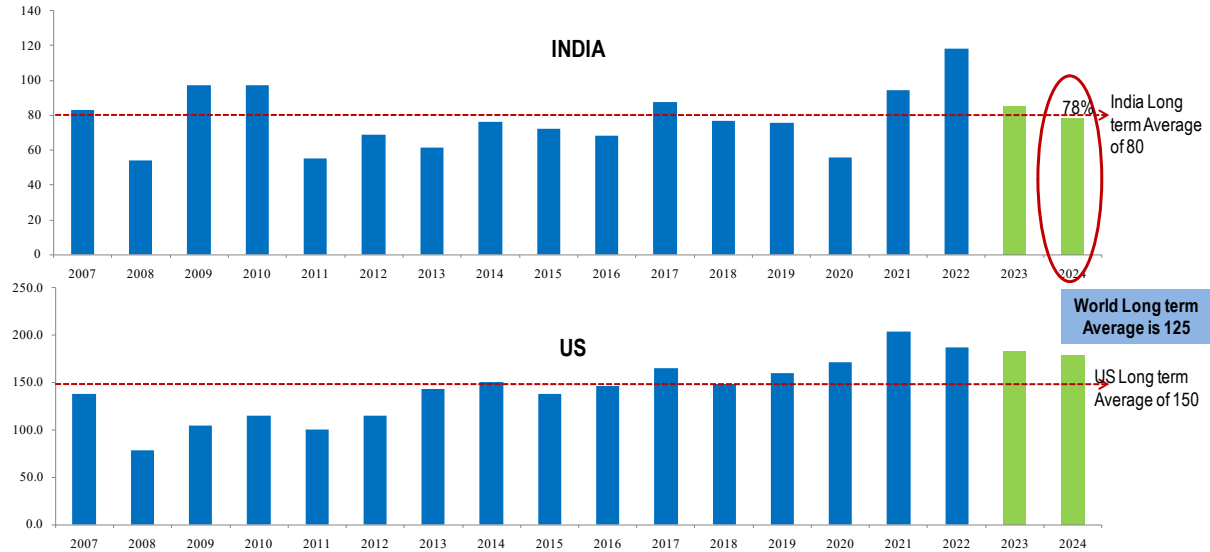
TREND REMAINS INTACT - INDIA IS PROGRESSING RAPIDLY

| Important Indicators | 2014 | 2021 | Important Indicators | 2014 | 2021 |
|-------------------------------|------|------|-------------------------|-------|-------|
| Economy Size (GDP) | 10 | 6 | Mobile Phone Production | 12 | 2 |
| Share in Global GDP | 2.6% | 3.2% | India's weight in BRICS | 13.5% | 21.5% |
| Share in Global Trade & Servs | 2.0% | 2.2% | India's weight in EM | 6.6% | 12.0% |
| Share in Global FDI | 2.1% | 6.7% | Global Innovation Index | 83 | 46 |
| Auto Production | 7 | 4 | WGI Governance Index | 103 | 49 |
| Steel Production | 4 | 2 | Ease of Doing Business | 142 | 63 |

- » Since 2014, India has continuously improved its global ranking in many progress indicators . We are now 5th in GDP ranking globally, 4th largest Auto producer, 2nd largest Steel producer and 2nd largest Mobile phone producer of the world.
- » India's weight in Emerging market has doubled to 12% since 2014
- » Ease of Doing business ranking has improved from 142nd to 63rd and so on
- » These trend influencing factors remain highly structural in spite of near term challenges

MARKET CAP TO GDP

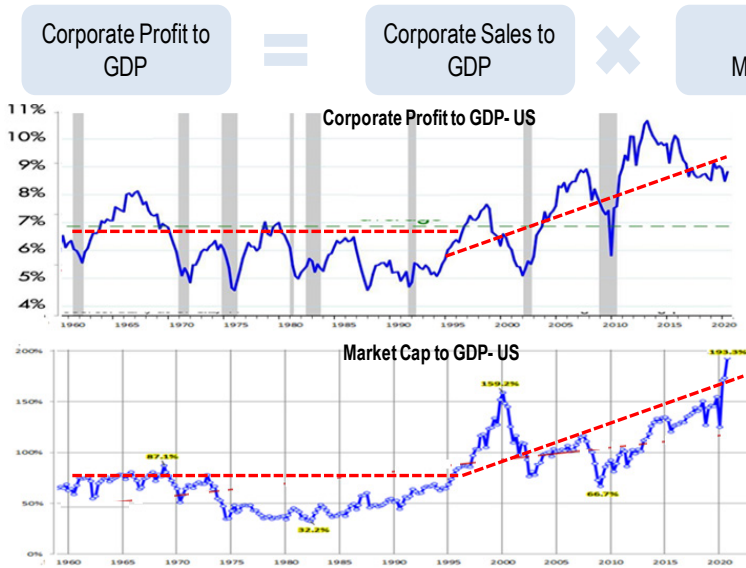
BUFFET INDICATOR



- » The market cap to GDP for India has fallen to 78% and is close to long term average of 80.
- » Also in a structural sense we expect the average of this indicator to move higher as corporate profit to GDP improves going forward

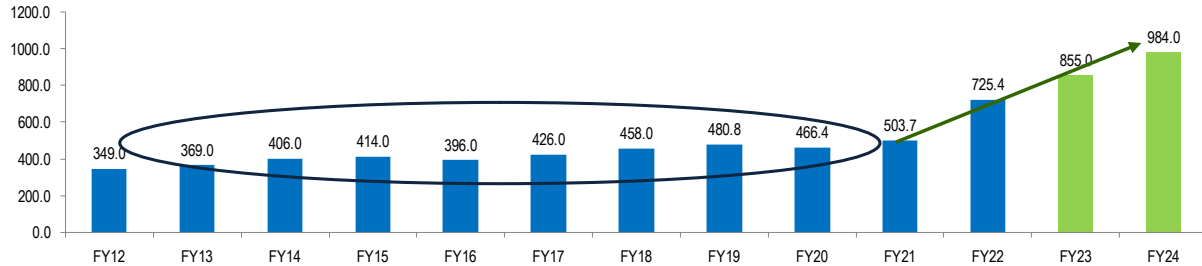
THE CONTEXT- "CORPORATE PROFITS TO GDP"

- » Every Valuation ratio has a certain context in which it can be best interpreted. Corporate profits to GDP share is the context in which we read the popular ratio- Market cap to GDP
- » As corporate profit to GDP improves, we should see the valuation range to move upwards.



| | US FY21 | INDIA FY21 | India FY24E |
|-------------------------|------------|---------------|----------------|
| Corporate Profit to GDP | 9.6% | 2.8% | 4.6% |
| Market Cap to GDP | 204% | 94% | 80% |

NIFTY EARNING PER SHARE IS GOING TO DOUBLE



| | FY22 | FY23E | FY24E |
|---------------------|-------|-------|-------|
| Nifty Current level | 15300 | 15300 | 15300 |
| Nifty EPS | 725 | 855 | 984 |
| Price Earnings | 21.1 | 17.9 | 15.5 |

- » Nifty during the last ten years have traded mostly in the range of PE of 17-24 and right now Nifty is trading at 15.5 X FY24 earnings. This makes the market even more compelling to invest for the long term. Nifty is expected to generate 20%+ annualized from level of 15300 in the next 2-3 years.
- » It is also important to remember that timing the market can prove to be risky. It is better to be stay invested in the market and be regular with it.

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